



METROPOLITAN
TRANSPORTATION
COMMISSION

Agenda Item 5c

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Memorandum

TO: Legislation Committee

DATE: March 7, 2008

FR: Executive Director

RE: SB 344 (Machado) — Bond Re-purchase

Description

This bill provides state and local governments with statutory clarification that they can temporarily re-purchase their outstanding bonds without causing the bonds to be extinguished or defeased. Existing law is ambiguous as to whether such a re-purchase triggers automatic extinguishment of the bonds. The statutory assurance would not override contractual terms between issuers and bondholders established in bond acts or bond issuing documents.

Recommendation: Ratify support

Discussion

The State Treasurer's Office indicates that California state and local government entities have roughly \$70 billion in variable rate bonds outstanding. If this measure were to reduce total interest costs on variable rate bonds by an average of just 0.5%, annual savings would be \$350 million.

This bill provides state and local governments an option for dealing with the current turmoil in the variable rate municipal bond markets, which has been caused by spillover effects of the sub-prime mortgage crisis. It enables issuers to temporarily purchase and hold their own bonds, thereby avoiding higher interest rates on variable rate demand bonds (VRDB).

Until this year, variable rate bond markets have functioned smoothly. In the past month, however, demand for these securities has fallen sharply, leading to abrupt increases in interest rates, and failed auctions, in the case of the variable rate demand market.

The recent turmoil in the variable rate markets is not due to financial problems on the part of state and local government bond issuers. Rather, the trouble is related to a loss of confidence in the liquidity of the short term VRDB and the auction-rate bond markets, as well as the downgrading of several large bond insurance firms.

Steve Heminger